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ECONOMIC REVIEW

third quarter july - september 2015

COMPILED BY KEITH JEFFERIS, BRANDON BASELE AND SETHUNYA SEJOE

COMMENTARY

Global slowdown bites as diamond sales fall, reinforcing the need for structural reforms

The third quarter of 2015 saw a further deterioration in global economic conditions, reinforcing a trend that had been gathering pace throughout this year. In contrast to the global financial crisis of 2008-9, which originated in the financial sectors of the major developed economies, this time the problems originate in the major emerging markets, notably China, Russia and Brazil. With growth slowing sharply in these and other emerging markets, the impact is being felt globally, especially in commodity markets, with mineral producing economies feeling a particularly severe impact.

Until the end of 2014, the global diamond market - which is the most important for Botswana - had in some respects felt the impact of the commodities slowdown less severely than other minerals. In the first half of 2015, pressures in the diamond market because more intense, with weakening final demand for jewellery and polished diamond putting downward pressure on rough diamonds prices and sales volumes. Unfortunately, any hopes of recovery in Q3 have been dashed, with total sales in the two De Beers global diamond sights held in Botswana in July and August down 70% on the same period in 2014. De Beers reduced rough diamond prices by 8-10%, but this has not been enough to encourage demand, especially as other producers – notably Alrosa of Russia - have cut prices even further. Reports are that diamond manufacturers have enough stock in the pipeline to cater for demand up to the end of the year, including the busy Christmas season, so any recovery will only come in 2016. Botswana's major diamond marketing channel outside of De Beers – the Okavango Diamond Company – has cancelled its November auction due to the depressed market.

The macroeconomic impacts of the intensified diamond market weakness have not yet started showing up in the data – figures for GDP growth, exports and government revenues are only available up to the middle of the year. Inevitably, Debswana has had to respond to weak demand for rough diamonds by cutting production targets, which will in turn feed through to Botswana's GDP growth. Lower exports and government mineral revenues will most likely lead to balance of payments and fiscal deficits in the second half of the year, perhaps extending into 2016. With Debswana's diamond output now projected at 20 million carats for 2015, total diamond production is likely to be more than 10% down on 2014. As a result, our revised forecast for real GDP growth for 2015 is now only 1%, lower than the revised projection of 2.6% released by the Ministry of Finance and Development Planning in its Budget Strategy Paper in September.

While developments in commodities markets are negative – for Botswana's copper and nickel producers as well as diamonds – the short-term impact should not be overstated. The mining sector is not closely integrated with the rest of the economy, and the mining slowdown does not immediately cause other economic activities to contract across the country, although there may of course be a direct effect in towns that are dependent upon mining. GDP data to the middle of 2015 indicate that growth in the non-mining private sector has continued at a robust rate of nearly 5%. Although there

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may be fiscal and balance of payments problems coming up, there is no immediate crisis. Budgeted government spending continues, even with revenue shortfalls, financed from accumulated savings. Imports can continue even with a decline in exports, financed by the foreign exchange reserves. And the Pula has been much more stable than most other emerging market currencies, with the exchange rate peg not under threat, and the currency's overall value (against the basket) preserved, in contrast to the sharp depreciation of some other regional currencies.

The immediate impact of the global slowdown on the economy is therefore limited. But there is nevertheless an increasingly negative mood with regard to economic prospects, and a lack of confidence in the business community, which goes deeper than the current malaise in commodity markets. In our view, this reflects a number of longer-term problems, in particular, but not limited to::

- Unreliable supply of water and electricity; this is an immediate problem in that it disrupts business operations, but also casts doubt on the ability of the state to discharge its obligation to supply basic public services, and its ability to plan and manage large infrastructure projects;
- Problems in obtaining work and residence permits for foreign investors and skilled employees, with a lack of transparency in the immigration system and a tightening of eligibility criteria that has resulted in firms being unable to invest and grow, some firms being closed down, and jobs being lost as a result;
- Slow progress in implementing promised reforms to improve the business climate;
- Slow progress in establishing a framework for public-private partnerships, even in areas where there is an urgent need, such as independent power producers (IPPs);
- No implementation of privatisation commitments, and a trend of establishing new parastatals and public corporations.

All of these add up to an environment of increasing economic uncertainty, which is a deterrent to investment both local and foreign, and job creation.

In response to declining business confidence, the slow pace of job creation and concerns about the impact of the global slowdown, His Excellency President S.K.I. Khama announced the introduction of an Economic Stimulus Package to boost economic activity. While details of the package have not yet been provided, it appears that it will comprise a range of infrastructure-related projects, some of which had been proposed earlier but postponed due to the non-availability of funds.

Analysis of the likely impact of the stimulus package is difficult in the absence of information regarding its content, timing, magnitude and funding. However, indications are that it will be large, and will be implemented as soon as possible. Fiscally, the impact will almost certainly be a move to larger budget deficits, over and above those that would be likely to result from the impact of the global slowdown and reduced mineral revenues. The stimulus will no doubt result in a short-term boost to economic activity and some job creation, particularly in construction and related activities such as building materials supplies, architects, surveyors and engineers.

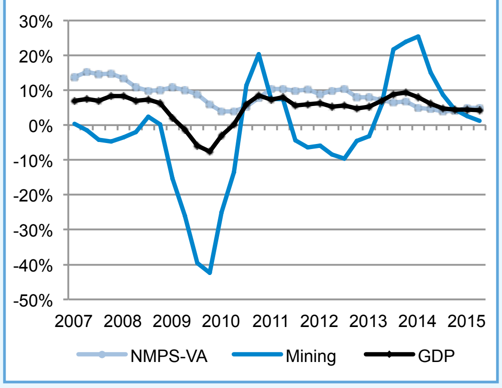
How the larger budget deficit will be funded has not yet been announced, although the government will have a choice between drawing down its savings at the Bank of Botswana (in the Government Investment Account, or GIA), or borrowing through bond issuance, or some combination of the two. Both funding approaches have advantages and disadvantages, and of course the Government's net financial assets will decline regardless of which method is used. However, it is worth noting that government can currently borrow very cheaply – the 25-year government bond is currently trading below 6% - and further bond issuance would be well-received by pension funds and asset managers.

There has been some suggestion that the spending will be financed by drawing down the foreign exchange reserves. However, this is not entirely accurate. Government does not own the foreign exchange reserves, and does not have direct access to them. Government's reserves, which can be used to directly finance spending, are in Pula, and are held in the GIA. There is an indirect link to the foreign exchange reserves, and it is likely that additional spending will eventually cause the foreign exchange reserves to be drawn down, but changes in the foreign exchange reserves are driven by the balance of payments, not by the government budget. A stimulus package with a high import component will most likely cause the foreign exchange reserves to decline, but this is a consequence of spending not of funding. In other words, additional spending will have the same impact on the foreign exchange reserves, regardless whether it is financed by drawing on government savings or by domestic borrowing.

Beyond the short-term impact on aggregate demand and the construction sector, and some boost to business confidence and job creation, it seems unlikely that the stimulus package will address underlying constraints or help move the economy onto a higher long-term growth path. The real causes of slowing growth are not a lack of government spending, but a lack of competitiveness. In some respects the stimulus package could make things worse. Numerous statements from the Minister of Finance and Development Planning, in Budget Speeches and Budget Strategy Papers, have rightly pointed out the need to improve the efficiency of government spending and project management, and to ensure that only high-return projects that can justify the financial investment required should be implemented. To this end, major improvements in the quality of public sector project selection and appraisal are required. A rush to implement projects under the stimulus package is unlikely to see these fundamental issues addressed. It is essential that a focus on additional short-term spending does not distract attention from the need for fundamental structural reforms that will addresses competitiveness and productivity issues, which are essential for sustainable long-term growth and job creation.

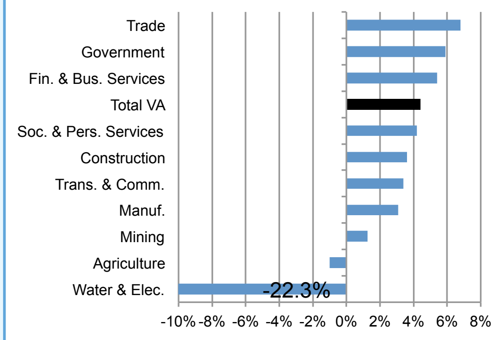
KEY ECONOMIC VARIABLES

Annual GDP Growth



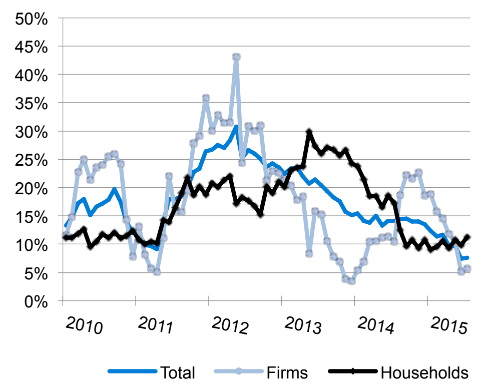
Economic growth fell from 4.5% during the year to Q1 2015 to 4.2% during the year to end of Q2. This was mainly attributable to the decrease in annual mining sector growth from 2.5% to 1.3% in Q1 and Q2 2015 respectively. Non-mining private sector (NMPS) growth remained constant at 4.9% throughout H1 2015, perhaps surprisingly in view of widespread negative economic sentiment.

Sector GDP Growth



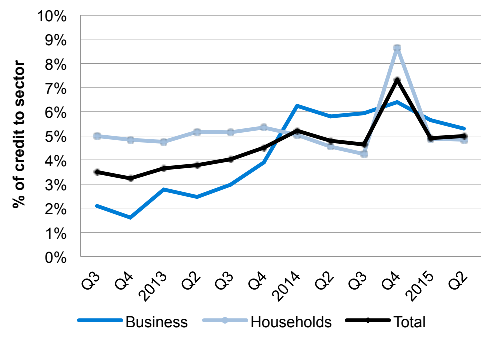
Trade was the fastest-growing sector of the economy during the year to June 2015, realising growth of 6.8%, followed by Government with annual growth of 5.9%. Water & electricity and agriculture contributed negatively to GDP growth, realising contractions of 22.3% and 1.0% respectively during the year to Q2 2015.

Annual Credit Growth



Annual bank credit growth decreased by almost half over the past year, from 14.2% in July 2014 to 7.6% in July 2015. Credit growth also decreased slightly between April 2015 and July 2015, from 9.8% and 7.6% annually. Firms were the most hard-hit, with growth in credit to private businesses falling to 5.6% in July 2015 from 11.8% in April, with the absolute value of the credit going down. In contrast, households have taken advantage of low interest rates to extend borrowing further, with credit to households up by 11.2% in the year to July 2015.

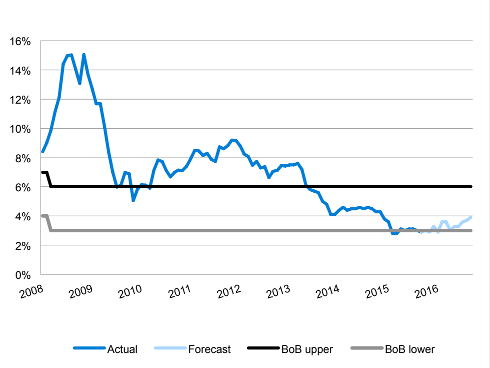
Arrears On Bank Lending



Arrears on bank lending to businesses declined slightly to 5.6% in Q2 2015, from 5.3% in Q1, signalling a continuous decrease since Q4 2014. This may be partly attributable to the tightening in the availability of credit to business during the quarter. Households also experienced a slight decrease in the level of arrears. However, overall arrears rose marginally, due to a jump in the level of arrears on bank lending to government/parastatals (the data from BoB do not distinguish which).

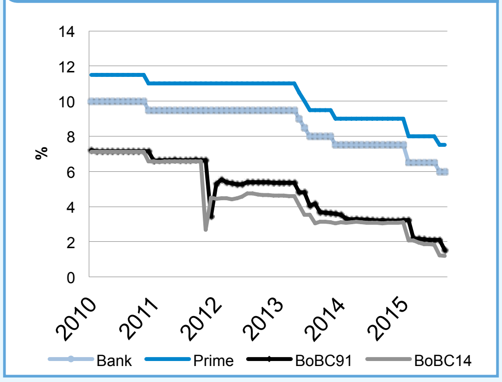
KEY ECONOMIC VARIABLES

Inflation and Forecast



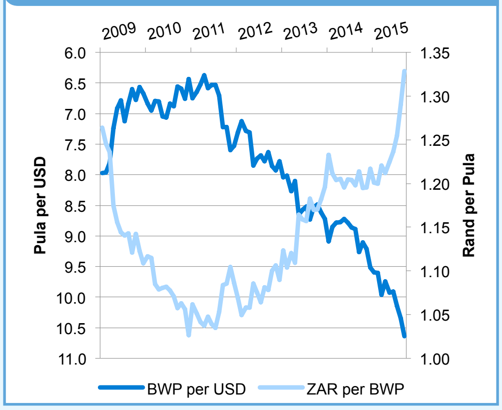
Inflation fell slightly in Q3, reaching 2.9% in September as compared to 3.1% in June, thereby falling just below the lower limit of the Bank of Botswana (BoB) inflation range. The decrease in inflation can be largely attributed to the decrease in domestic fuel prices in early September. Food price inflation also remains very low. However, underlying inflationary pressures are rising, with prices for all items excluding food, fuel and alcohol up 6.2% in the year to September. We expect inflation to rise gradually towards 4% over the next 12 months.

Interest Rates



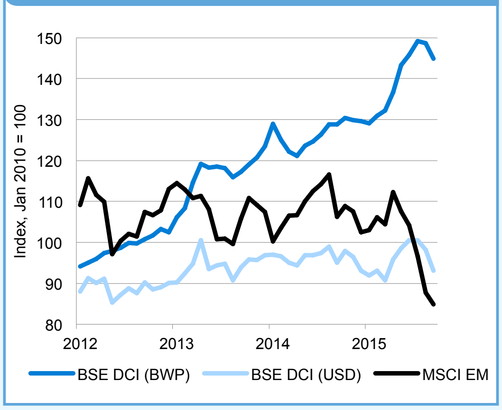
The Bank Rate was reduced by 0.5% during Q3 2015, to 6%. This was the second cut in the Bank Rate during the year, after being kept unchanged for the whole of 2014, and reflects the significantly lower headline inflation rate during this year. The cut subsequently led to a decrease in the BoBC-14, BoBC-91 and prime lending rates. There are now mixed opinions regarding the future direction of interest rates, with some commentators pointing to a further rate cut in the near future, due to the low level of headline inflation, while others suggest that this would be unwise given the likelihood that inflation will rise over the next 12 months.

Exchange Rates



The US Dollar (USD) continued to strengthen during Q3 relative to most currencies, including the Pula (BWP). As at the end of September, USD1.00 was equivalent to BWP10.64, a 7.3% appreciation during the quarter. Conversely, the South African Rand (ZAR) has continued to depreciate relative to the BWP, falling by 6.9% during Q3. Since the end of the quarter, however, the rand and the Pula have regained some strength against the dollar.

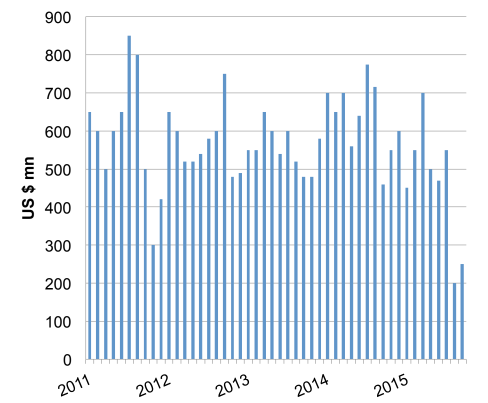
Stock Markets



Q3 2015 was a lacklustre quarter for the Botswana Stock Exchange, as the DCI fell in both Pula and dollar terms, by 0.6% and 7.4% respectively. However, the BSE outperformed the MSCI EM index, which fell by 18.5%, having been hit hard by the economic downturn in China and the consequent decline commodity prices.

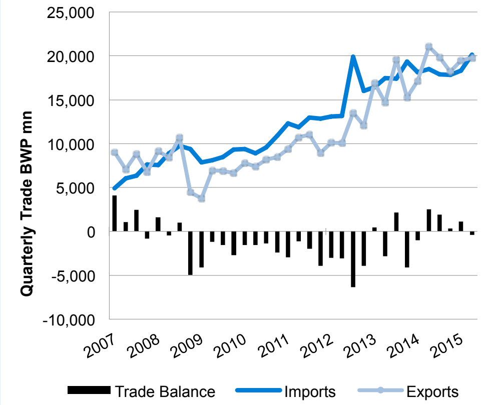
KEY ECONOMIC VARIABLES

DTC Sales



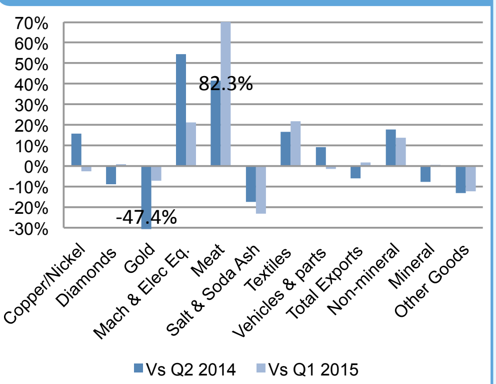
Q3 2015 only saw two sights, in July and August, with a combined value of USD450mn. This is very low when compared with the USD1,490mn sold in Q3 2014. With a sombre mood at each of the sights, De Beers reduced rough prices by 8% to 10%, at the August sight, in response to softening polished prices. Sightholders were also allowed to defer up to 75% of their allocated supply to later in the year.

Trade



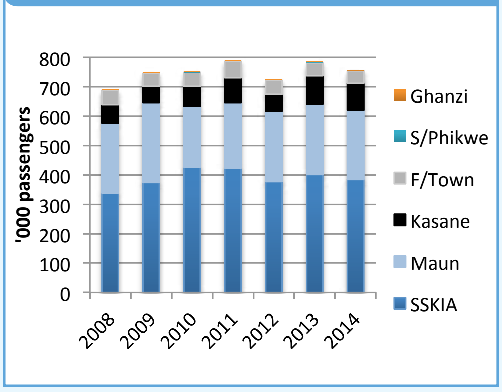
During Q2 2015 a small trade deficit was realised, following four consecutive quarters of trade surpluses. The move into deficit was mainly attributable to a 10% rise in the value of imports in Q2 as compared to Q1. Although the import bill for fuel dropped further (to P2.1bn), expenditure on imports of diamonds (P7.9bn), food and beverages (P1.9bn) and machinery (P2.4bn) all rose significantly.

Export Growth



Q2 2015 saw a decrease in exports of copper/nickel, gold and salt & soda ash, which fell by 2.6%, 7.3% and 23.0% respectively, relative to Q1 2015. The decrease in copper/nickel exports is mainly attributed to the economic slowdown in China, falling commodity prices and the closure of the BCL smelter in July for refurbishment. There welcome increases in exports of beef, machinery and textiles.

Air Passenger Traffic by Airport



Air travel data show that the number of passenger movements in all Botswana airports fell by 3.7% in 2014 as compared to 2013. Of the total, Sir Seretse Khama International Airport accounted for 51% of passengers, Maun 31%, Kasane 12% and Francistown 6%. Data on SSKIA for 2015 show that passenger numbers dropped by a further 5% in the first seven months of the year compared to a year earlier. This latest decline reflects the impact of the global and regional economic slowdown, new regulations in South Africa restricting travelling with children, and the impact of the Ebola virus on international tourism.

NEWS HIGHLIGHTS

2nd July	Shumba Coal plans 200MW solar plant. (Mmegi)	According to an Environmental Impact Assessment (EIA) public notice from Shumba Coal, the company is considering the development of a 100MW solar power station in north-western Botswana. The intention is to supply mines in the Kalahari copper belt, which are currently outside the national electricity grid.
3rd July	Services sector drives economic growth. (Mmegi)	Statistics Botswana (StB) figures showed that the services sector drove economic growth in the first quarter of the year as mining production, the country's traditional economic mainstay, slowed. Real Gross Domestic Product (GDP) grew by 4.3% in Q1 2015, compared to 3.6% realised the same quarter in 2014. Slower mining growth is attributed to a fall in diamond production by 2.5%.
9th July	Khoemacau to spend P2 bn on new copper mine. (Mmegi)	Construction works at Khoemacau Copper's new P2 bn copper and silver mine at Somelo in the north-west region are expected commence in 2016, with first sales in 2018. The copper and nickel mine is expected to produce 50,000 tonnes of copper and 1.8 mn ounces of silver every year.
9th July	Govt invites bids for solar power plants. (Mmegi)	The government of Botswana has published an Expression of Interest notice inviting bids from companies to construct and operate 100MW solar power stations to supply Jwaneng and the north-west region.
10th July	World Bank warns Botswana. (Mmegi)	The Systematic Country Diagnostic (SCD) report by the World Bank has cautioned Botswana over unsustainable consumer spending that is increasingly replacing diamond exports as the key driver of economic growth. The report states that while economic diversification is welcome, economic growth that is dependent on consumer spending poses high risks to the economy, given the weak capacity by the private sector to create jobs, low wage growth and increasing household debt.
10th July	Botswana's statistical capacity declining. (Mmegi)	According to the World Bank's SCD report, Botswana's statistical capacity has been declining over the past decade, constraining implementation of evidence-based policy making. The SCD reported that the transformation of StB from a government department to a semi-independent agency, the low frequency of data collection, and delays in dissemination are some of the reasons for declining performance.
10th July	Power imports decrease due to Eskom shortages. (Mmegi)	Figures released by StB showed that power imports decreased by 26.8% in Q1 2015, from 616,206 MWH realised the same quarter last year to 451,092 MWH. The fall in imported electricity, however, did not mean increased domestic production; rather, Botswana Power Corporation (BPC) could not secure adequate supplies from South Africa's Eskom, leaving BPC to implement demand side tools to manage the consumption of electricity given the shortfall in supply.
14th July	ODC sales dip 23% as diamond market softens. (Mmegi)	Okavango Diamond Company (ODC) rough diamond sales fell 23% year-on-year to USD231 mn in the first half of 2015. Sales by volume dropped 21% and the company sold 745 of the 794 lots on offer. ODC's stakeholder relations executive officer stated that plans are in place to introduce contract sales as the company currently only sells through auctions.

NEWS HIGHLIGHTS

14th July	African Copper's debt balloons to P1,2 bn. (Mmegi)	Cash-strapped copper producer, African Copper, secured another $2 mn (P20 mn) loan facility from its parent company ZCI's controlling party Copper Belt Development Foundation. Following the closure of one of its two mines, Thakadu, the company announced a significant cut in production at the Mowana mine, and looks to delist from the Botswana Stock Exchange (BSE).
15th July	BCL smelter shuts down for refurbishment. (Mmegi)	The Bamangwato Concessions Limited (BCL) mine's P700 mn smelter shutdown exercise has commenced. The refurbishment is meant to modernise the smelter to operate for a longer service period and improve its capacity to treat nickel concentrates.
16th July	Access to financial services improves. (Mmegi)	Financial inclusion has increased from 69% in 2009 to 76%, with only one out of every four Batswana having no access to banking or other formal and informal financial services, Finmark Trust's FinScope consumer survey revealed. The uptake of non-bank formal products also increased from 37% to 56% and was mostly driven by the PosoCard. On regional rankings, Botswana ranked 5th in Southern African Development Community (SADC) for the financially served population.
17th July	Survey: 90% of Batswana earn below P10,000 monthly. (Mmegi)	Drawing on the results of the FinScope Survey, Making Access Possible (MAP) report revealed that about 90% of Batswana earn below P10,000 per month.
17th July	Air Botswana on steady recovery – GM. (Mmegi)	Air Botswana general manager, Ben Dahwa, informed stakeholders that the national airline's operational efficiency has been rising steadily since last year, with its on-time performance (OTP) reaching 87%.
17th July	Govt revenues face drop as De Beers' sales plunge. (Mmegi)	Government revenues are expected to be negatively impacted by low rough diamond sales by De Beers. According to figures released by Anglo American, De Beers' production fell 6% to 7.97 mn carat in the first half of the year. Total rough diamond sales by volume decreased 26% in the same period while sales by value are projected to have declined by 28% to USD2.5 bn. Further sales declines are expected.
23rd July	Insurance Industry Bill gets Parly nod. (Mmegi)	In a major boost to the local insurance industry, Parliament gave the go-ahead to the Insurance Industry Bill, which will overhaul the regulation of the insurance industry in Botswana. The Bill will replace the existing Insurance Act, which dates back to 1987.
26th July	Boseto mine set to resume operations. (Daily News)	Plans are underway to re-start operations at Khoemacau Copper's Boseto mine in the next 2 to 3 years. The mine was shut down early this year following provisional liquidation which led to hundreds of jobs being lost.
29th July	Over P800 mn saved in Metshelo. (Mmegi)	The Making Access Possible (MAP) report revealed that an estimate of 236,000 people participate in community savings and credit vehicles, popularly known as Metshelo, which hold approximately P822 mn in savings. The usage of Motshelo schemes was found to be particularly high among the informal SME groups.

NEWS HIGHLIGHTS

5th August	BMC's P300 mn bailout gets Parly nod. (Mmegi)	Parliament approved the requested capital injection of P300 mn to relieve the cash strapped Botswana Meat Commission (BMC) from its financial woes. It was further stated that the requested funds would be financed by reducing the annual provisions for the horticulture and water development and agricultural support scheme programmes.
6th August	Bank Rate cut to 6%. (Bank of Botswana)	The Bank of Botswana's Monetary Policy Committee (MPC) reduced the Bank Rate by 50 basis points to 6%. According to BoB, the easing of monetary policy was motivated by the current state of the economy and domestic and external economic outlook, and was consistent with maintaining inflation within the BoB's medium-term objective range of 3-6%.
9th August	BMC exempted from tax. (WeekendPost)	Parliament has passed the Income Tax amendment bill, which will exempt the Botswana Meat Commission (BMC) from taxation. It also introduces a 4% withholding tax on livestock sales, which will be deducted from the price paid for cattle bought slaughter or for feeding for slaughter.
10th August	NBFIRA to crack whip on errant micro-lenders. (Mmegi)	NBFIRA has urged micro-lenders to register with them and vowed to take action against those who continue to operate without licenses. The non-banking regulatory body stated that they continue to encounter cases where some businesses are operating without licenses.
14th August	BSE market cap reaches historic P50 bn mark. (Mmegi)	Market capitalisation for the domestic bourse reached P50 bn in the second quarter of this year, the highest in the history of the BSE. According to the quarterly report from Motswedi Securities, shares worth P244.8 mn were traded in Q2, 69% higher than in Q1 2015. Letshego recorded the highest trade volumes at 35% of total volumes traded.
18th August	Karowe, Lucara's gem, continues to deliver exceptional diamonds. (Mining Weekly)	Lucara Diamond Corp has reported that its Karowe mine continues to deliver according to expectations by recovering exceptional diamonds. An enormous Type IIA, 336 carat diamond was recovered just days after discovering 184 carat, 94 carat and 86 carat diamonds, and a 12 carat pale pink diamond.
18th August	Industry headwinds halve Stanchart's profits. (Mmegi)	According to its recently-published financial statements, the tough trading environment in the banking sector - characterised by low interest rates and tight liquidity - has slashed Standard Chartered Botswana profits by more than half in the first half of the year. Profit after tax declined by 61% to P66.2 mn.
25th August	De Beers price cuts could top 10% at sight. (Rapaport News)	De Beers is reported to have reduced prices at the August sight by as much as 10.7% on some goods. The price reduction came at a time when the company was already allowing sight holders to defer pre-agreed purchase commitments.
25th August	Russia outshines Botswana as world's top diamond producer in 2014. (Rapaport News)	Russia displaced Botswana as the world's largest diamond producer by value and volume. According to data released by Kimberly Process Certification Scheme (KPCS), Russia's diamonds by volume increased 1% to 38.3 mn carat worth USD3.73 bn in 2014. Diamond volumes for Botswana increased by 6% to 24.7 mn carat worth USD3.65 bn in value in 2014. Canada and Angola took positions three and four respectively.

NEWS HIGHLIGHTS

11th September	Botswana's Debswana cuts diamond production due to market downturn. (Mining Weekly)	Debswana Diamond Company has cut its 2015 production target to 20 mn carats from 23 mn carats due to sluggish demand in the diamond market.
11th September	Letshego obtains Tanzanian banking licence. (Mmegi)	Botswana's largest micro-lender, Letshego, says it has obtained approval from the Central Bank of Tanzania to operate as a deposit-taking financial institution in Tanzania.
11th September	Budget deficit seen narrowing in 2016. (Mmegi)	The revised 20016/17 Budget Strategy Paper (BSP) from MFDP projected a budget deficit of P4.03 bn from the previous budget surplus estimate of P1.23 bn for the 2015/16 fiscal year. Estimated GDP growth has been cut to 2.6% from 4.9%. The weakened diamond market and possible drop in Southern Africa Customs Union (SACU) revenues are the major contributors to the projected budget deficit.
11th September	SA power tender lights up coal sector. (Mmegi)	The government of Botswana has issued three coal companies - Shumba Coal, African Energy and Jindal Africa - with support letters in their bids for a 600MW supply contract floated by South Africa's Department of Energy.
13th September	Morupule A to commence operation. (Botswana Weekly & Review)	The Permanent Secretary of the MMEWR stated that the old Morupule Power Station (Morupule A) will start commercial operation by the 2016/17 financial year, following refurbishment. This is part of the government's strategy for long-term security of electricity supply which includes a proposed greenfield 300MW coal fired power station, the extension of Morupule B, and a 100-200MW solar project.
13th September	BMC's Maun abattoir reopens after renovations. (Sunday Standard)	The BMC reopened its Maun abattoir after renovations that will increase slaughtering from 100 to 120 beasts per day, with further expansion if demand increases.
13th September	Letlhakane uranium mine targets 3.75 mn pounds output. (Sunday Standard)	Following the completion of an environmental and social impact assessment, ASX-listed A-Cap Resources announced the submission of a mining licence application for its Letlhakane uranium project. The results from technical studies have shown that the project could produce about 3.75 mn pounds of ore in the first five years of its projected 18 year life. Construction work is expected to commence next year.
15th September	Reserves, bonds to fund 2015/16 deficit. (Mmegi)	The Government intends to finance the projected P4.03 bn budget deficit for the 2015/16 financial year by issuance of bonds and drawing from government reserves.
16th September	BoB fines banks P1 mn for breaching liquidity limits. (Mmegi)	The BoB has instituted a fine on commercial banks that have failed to comply with the 10% liquidity requirement, as provided for under the Banking Act.
18th September	Mohohlo breaks silence on dented banking margins. (Business Weekly)	BoB governor Linah Mohohlo stated that the banking sector is becoming competitive in an environment of declining interest rates and excess liquidity. Banks' total profits decreased from P1.8 bn in 2013 to P1.5 bn in 2014, indicative of increased competition between commercial banks.

NEWS HIGHLIGHTS

20th September	Trans-kalahari railway project takes a step forward. (Sunday Standard)	The governments of Botswana and Namibia have employed key personnel to spearhead the next stage of the development of the Trans-kalahari railway project scheduled to commence once legal and cross border issues have been cleared by the two countries.
21st September	Botswana and ALROSA start Orapa license work. (Rapaport News)	Botswana Diamonds reported that work is underway on the three prospecting licenses in the Orapa region of Botswana, as part of a joint venture with the Russian firm ALROSA.
21st September	Botswana loses shine in the beef market – BIDPA. (Weekend Post)	A study carried out by the Botswana Institute of Development and Policy Analysis (BIDPA) on the competitiveness of the beef industry revealed that industry output has been declining over the years, eroding competitiveness in the beef export market. Institutional and supply side factors such as having a single (monopoly) export channel through the BMC, and lower real producer prices, are some of the factors contributing reduced competitiveness and export supply.
22nd September	SA to cut off water supply. (Mmegi)	Water Utilities Corporation (WUC) officials will meet their South African counterparts on the 1st October, to discuss the supply of water from Molatedi Dam to Gaborone. Under an agreement between Botswana and South Africa, water supplies from Molatedi are reduced when water levels in the dam fall below 26%.
23rd September	Business Botswana recommends review of levies. (Sunday Standard).	In its position paper on the reform of levies, many of which act as hidden taxes, Business Botswana recommended the review of government levies citing that they are problematic and escalate the cost of doing business in the country.
25th September	Namibia, Botswana and Ghana among the world's top ten mining investment destinations. (Mining Weekly)	The three African countries have been ranked the most attractive mining investment destinations by Behre Dolbear. Out of 25 countries, Namibia ranked 7th followed by Botswana at 8th and Ghana 10th. The survey considered seven criteria: political economy, currency stability, social license issues, permitting processes, competitive taxation policies and corruption levels.
25th September	Barclays profits fall 30% on market headwinds. (Mmegi)	A combination of low interest rates, fee moratorium and tight liquidity conditions ate into Barclays Bank of Botswana's financial results for the half-year ending 30 June 2015. The bank recorded a profit before tax of P110 mn for half the year ending in June 2015, lower than the P160 mn realised the same period last year.
30th September	New data shows collapse of imports and exports. (Sunday Standard)	StB's Botswana International Merchandise Trade Statistics (BIMTS) monthly digest indicated a fall in both imports and exports in July, as diamond imports and exports declined in the period. Total imports and exports for July 2015 fell 36.6% and 37.9% from the previous month's values of P8,010.2 mn and P7,400.5 mn respectively, representing a decrease of 8.4% for imports and 44.4% for exports compared to the same period in 2014.

MACROECONOMIC DATA

Key Economic Data	unit	2012	2013	2014	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015Q3
Annual Economic Growth									
GDP	%	4.8	9.3	4.4	4.8	4.4	4.5	4.2	
Mining	%	-4.6	23.9	4.5	8.7	4.5	2.5	1.3	
Non-mining private sector	%	8.0	6.8	4.1	3.9	4.1	4.9	4.9	
GDP current prices	P mn	112,705	125,810	141,942	34,978	36,878	36,108	37,206	
GDP 2006 prices	P mn	75,786	82,851	86,514	21,652	22,365	21,952	21,865	
Money & Prices									
Inflation	%	7.4	4.1	3.8	4.5	3.8	2.8	3.1	2.9
Prime lending rate	%	11.0	9.0	9.0	9.0	9.0	8.0	8.0	7.5
BoBC 14-day	%	4.6	3.1	3.1	3.1	3.1	2.1	1.9	1.2
Trade & Balance of Payments									
Exports - total goods	P mn	45,719	66,392	76,194	19,803	18,172	19,459	19,772	..
Exports - diamonds	P mn	36,143	55,367	65,327	16,967	15,054	16,463	13,905	..
Imports - total goods	P mn	62,112	70,725	72,391	17,887	17,835	18,316	20,147	..
Balance of visible trade	P mn	-16,393	-4,333	3,802	1,916	338	1,143	-375	..
Balance of payments	P mn	-862	1,340	11,404	1 082	2 701	4,998	..	..
Foreign Exchange									
Exchange rate BWP per USD	end	7.776	8.718	9.515	9.259	9.515	9.960	9.911	10.638
Exchange rate ZAR per BWP	end	1.090	1.196	1.217	1.214	1.217	1.221	1.237	1.329
FX reserves	$ mn	7,628	7,726	8,323	8,240	8,323	8,571	8,572	..
FX reserves	P mn	59,317	67,772	79,111	76,295	79,111	85,194	84,536	..
Financial Sector									
Deposits in banks	P mn	47,216	48,512	53,231	56,328	51,492	61,637	57,628	..
Bank credit	P mn	34,555	39,763	45,116	44,138	45,116	45,694	45,866	..
BSE index		7,510.2	9,053.4	9,501.6	9,440.0	9,501.6	9,693.9	10,690.1	10,624.3
Business Indicators									
Diamond production (a)	'000 cts	20,619	23,134	24,658	6,321	6,103	5,722	5,999	..
Copper production	tonnes	57,916	49,448	46,721	12,453	12,969	9,653	5,661	..
Nickel production	tonnes	17,942	22,848	14,958	2,810	5,299	5,169	4,046	..
Business confidence index		47%	45%	52%	52%	..	44%	..	
No. of companies formed		16,561	14,190	16,300	4,682	4,013	5,238	4,904	5,071
Electricity consumption	GWh	3,703	3,502	3,990	1,036	1,013	970	..	..
Crude oil (Brent)	$/bar	110.80	109.95	55.27	94.67	55.27	53.69	60.31	47.29
Employment (formal)									
Government		131,033	130,175	..	..	..	..	..	..
Parastatals		17,484	18,838	..	..	..	..	..	..
Private sector		188,531	189,894	..	..	..	..	..	..
Total		337,048	338,907	..	..	..	..	..	..

Govt Budget		2013/14	2014/15 Revised	2015/16 Budget
Revenues	P mn	48,951	51,544	55,382
Spending	P mn	41,730	51,263	54,153
Balance	P mn	7,222	281	1,229
Public debt & guarantees	P mn	30,769	32,064	31,931
Govt deposits at BoB	P mn	31,745	41,680	..
GDP	P mn	130,457	144,367	155,735
Revenues	%GDP	37.5%	35.7%	35.6%
Spending	%GDP	32.0%	35.5%	34.8%
Balance	%GDP	5.5%	0.2%	0.8%
Public debt & guarantees	%GDP	23.6%	22.2%	20.5%
Govt deposits at BoB	%GDP	24.3%	28.9%	..

Sources: Bank of Botswana; MFDP; Statistics Botswana; Department of Mines; Registrar of Companies; Econsult
Notes: (a) 2013 figures include production from Boteti Diamond and Debswana
(b) Numbers in Italics reflect revisions from the previous review

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What is Happening to Foreign Direct Investment in Botswana?

Like any developing nation, Botswana requires investment for sustainable economic development and growth. In principle, the financing of investment can be derived from domestic sources (savings) or from foreign sources, whether in the form of borrowing from outside of the country or foreign direct investment. For many years, Botswana has been in the fortunate position that domestic savings have generally been sufficient to finance domestic investment, based on mineral revenues, especially diamond revenues. Good management of these revenues and a high level of investment have enabled Botswana to achieve middle income status, transforming from being one of the poorest in the world. Unlike many countries, Botswana generally runs current account surpluses, and hence in macroeconomic and financial terms the need for capital inflows is limited, as the economy has a surplus of savings over investment.

Despite a favourable macroeconomic balance and a high level of domestic savings, foreign direct investment has nevertheless played a crucial role in Botswana's economic development trajectory, and economic policy envisages an increasingly important role for FDI going forward. Although the composition of Gross Domestic Product (GDP) suggests some level of diversification in the economy, Botswana's exports are still dominated by mineral exports (more than 80 percent). Diversifying the export base of the economy, and a movement away from growth led by government and mining to growth led by the private sector remain crucially important economic development objectives. Private sector development remains a priority for economic diversification. Inflows of FDI also help to build up the foreign exchange reserves.

FDI is defined as a long lasting investment that is made to expand, acquire or establish an entity by a national not of a country in which the investment is made. Openness to inflows of FDI is important in an export diversification strategy. It is not so much the finance that FDI brings, but other attributes that are important. Foreign investors are more likely to be attracted to Botswana as a base for export production of goods and services, given the limited size of the domestic market. Foreign investors typically have access to markets, are integrated into global supply chains, and have access to technology. It is well established that foreign investors are more likely to be exporters than domestic investors. Therefore, inflows of direct investment bring with it external forward linkages in the form of access to international markets and integration into global markets.

In many cases (notably for activities that are not related to mining), investors have a choice as to where they invest. Several factors determine the location in which the investor decides to invest. Such determinants of investment include political risk, the ease of doing business, market size, resource endowment, availability of inputs and skilled labour, costs and competitiveness, and openness to trade. The availability and quality of support infrastructure like water, electricity, roads and internet also determine inflows of foreign direct investment.

Officially, the government of Botswana is committed to attracting inflows of direct investment, and has, for instance, established the Botswana Investment and Trade Centre (BITC) to facilitate inward investment. Given the importance of FDI, it is important to track whether the policy has been successful. The BITC Annual Report for the year to March 2014 notes that BITC-registered companies invested P691 million over this period, but does not distinguish between domestic and foreign investment.

An alternative data source is the information published by Bank of Botswana in the Botswana Financial Statistics. Specifically, the International Investment Position (IIP) is published each year, and among the various components of the IIP is investment by non-residents in Botswana. By tracking changes from year to year, annual flows of (net) FDI can be derived.

Foreign Direct Investment (FDI) Flows in Botswana

Using the IIP data over the period 2005-2014, we can see that in Pula terms, FDI inflows vary considerably from year to year. Notably, after increasing slowly between 2005 and 2008, FDI decreased significantly in 2009 - 10 before recovering sharply in 2011, then dropping back since then. During these periods, Botswana was hit by the 2008-9 global financial crisis, which was felt by the global economy and caused investment flows everywhere to decline.

The peak in 2011 is attributable to economic activity in the mining sector, particularly investments associated with Debswana's "Cut 8" project to extend the life of the Jwaneng mine. Other notable economic activities included the relocation of the Diamond Trading Centre (DTC) to Gaborone and investment in sectors like finance.

Notwithstanding these flows, the general trend in foreign direct investment in Botswana shows a downward movement when compared to the size of the economy – i.e. as a share of Gross Domestic Product (GDP). Apart from the peak in 2011, FDI has declined from nearly 5% of GDP in 2006 to only 2.5% of GDP in 2014 – a fall of almost 50%. The trend over this ten year period is clearly downward.

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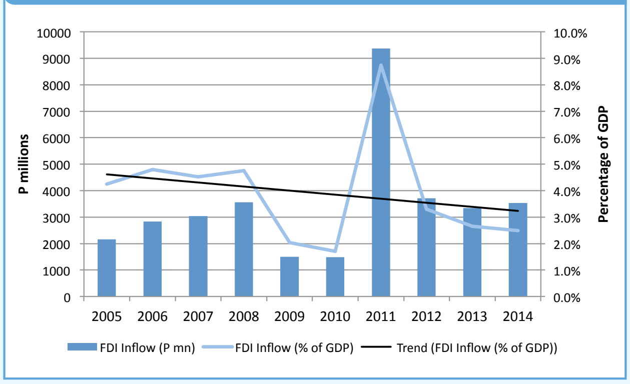
Figure 1: FDI Inflow in Botswana



Source: Bank of Botswana, Econsult Botswana

What explains this trend in Botswana's FDI?

Separate data published by the BoB shows that FDI in Botswana is dominated by the mining sector, followed by banking and finance Mining investment tends to be lumpy (i.e. invested in large projects) and hence varies considerably from year to year. Furthermore, the performance of the mining sector has been highly variable in recent years, and is subject to major variations in global demand, which in turn impacts on economic growth – as evidenced by the revision in official growth projections for 2015 from 4.9 percent to 2.6 percent as a result of softened rough diamond demand.

Another important point is that the structure of the economy has over the years shifted away from mining, manufacturing and agriculture towards services; many service activities require relatively little fixed capital, as compared to mining and manufacturing.

Nevertheless, the downward trend is a concern. Botswana should be attracting increased FDI inflows if export-led economic diversification is to be achieved. The country's performance is fluctuating in global competitiveness rankings. For instance, Botswana's score deteriorated on the World Bank's Doing Business ranking in 2015 as compared to 2014, but improved slightly in the World Economic Forum's Global Competitiveness Index.

From these reports, poor work ethic of the labour force, inefficient government bureaucracy, restrictive labour regulations, access to finance and the small market size are cited as problematic factors for doing business in Botswana.

Other factors such as the high costs of internet connectivity, transport and disruptions from the water and electricity sector negatively affects the doing business environment. Overall, Botswana's investment policy has not been as successful as it should have been, despite the government's efforts to make the business environment competitive to attract direct investment. Furthermore, better data is necessary to enable improved monitoring of FDI trends in different sectors of the economy.

Botswana BSE-Listed Companies and Cross-Border Growth

Introduction

The Botswana Stock Exchange (BSE) is home to some of the largest companies in the economy. These companies cover a range of economic activities, but are mostly concentrated in the services sector. In this note we examine an increasingly prominent characteristic of many of these companies, that of continued growth through expansion into other countries in Southern and Eastern Africa. Based on discussions held with several of these companies and reviews of annual reports and other documentation, we analyse the nature and extent of this expansion, identify its drivers and consider the advantages and disadvantages of using Botswana as a base for regional expansion and as a hub for regional operations. In contrast to the previous feature article, which referred to Foreign Direct Investment flows into Botswana, this relates to outward FDI by Botswana firms.

There are 22 domestic companies listed on the main board of the BSE. Of these, six are Botswana franchises of international companies, such as the listed commercial banks, and do not have the freedom to expand into other countries[1]. Of the remaining 16 companies, 13 have regional operations in countries outside of Botswana. Almost all of them originated in Botswana, and now use Botswana as their primary hub for regional operations. .

The Story

In recent years, companies listed on the domestic bourse have been expanding beyond the borders of Botswana, particularly into the SADC region. The expansion has been particularly marked in sectors such as financial services and retail, but also includes tourism and personal services.

Although regional expansion has gathered pace in recent years, the process has been under way for more than 20 years. The first company to grow cross border was in 1993, when Wilderness (tourism) expanded into Namibia and South Africa, and Malawi and Zimbabwe shortly afterwards. Later in the 1990s, RDC (property) invested in Madagascar, and Furnmart (retail) commenced operations in Namibia.

Since that time, perhaps the most dynamic regional growth has been driven by Letshego (financial services) which expanded first into East Africa (Uganda) and now has operations in eight African countries outside of Botswana, and Choppies (retail), which grew rapidly in Botswana in the 2000s and has since expanded into South Africa, Zimbabwe and Kenya. Perhaps as a reflection of this growth, Letshego and Choppies are, respectively, the second and third largest companies on the BSE, by market capitalisation.

In pursuing regional growth, companies have used a mixture of business models, including establishing new business operations (greenfield) and taking over existing businesses (brownfield). There is no predominant model, with almost equal numbers of brownfield and greenfield expansions.

Most of the expansions have been within SADC, which offers attractive market prospects and a population of 277 million. However, many of these companies have expanded their operations into a similar, smaller set of countries. All of the 13 companies had a subsidiary in one or more of Namibia, South Africa, Zambia, Zimbabwe. This is not particularly surprising, given that all of these countries share borders with Botswana, hence placing them in close proximity for infrastructure, trade and communications purposes. However, East Africa is gaining popularity, with several companies having subsidiaries in member states of the East African Community (EAC), including Kenya, Tanzania, Uganda and Rwanda; the EAC also offers a substantial market, with a population of 146 million. Six of the 13 companies have a presence in East Africa.

Despite extensive regional growth, for the majority of companies Botswana is still the most important part of their business and contributes more than half of turnover and profit in almost all cases. Nevertheless, for Furnmart – amongst the first to develop regional operations – the business outside of Botswana contributes more than half of the total. For Choppies and Letshego, the total size of ex-Botswana operations is likely to surpass those in Botswana in the near future. For all others, Botswana remains dominant, but with operations outside of Botswana typically contributing 20%-40% of total turnover. However, growth in turnover, as opposed to the level of turnover, is much more dependent on expanding regional operations.

Imara presents something of an exception to the general story, in that it is the only company that did not originate in Botswana, but chose Botswana as its choice of hub rather than its home base in Zimbabwe. Until recently African Banking Corporation Holdings (ABCH) followed the same path, but it has now de-listed from the BSE.

[1] The franchisees include FNB, Barclays, Stanchart (banking), Sechaba (brewing), Engen (fuel) and G4S (security).

A common characteristic of this regional growth is that all of the activities involve products that have to be produced in the country where they are consumed, whether for economic or regulatory reasons. For instance, tourism services, retail services, property development, and many financial services need to be produced where they are consumed, rather than traded across borders. Hence firms are required to have a presence in the market concerned, rather than producing elsewhere and supplying through trade (and therefore contrasts, for instance, with trade in goods). Expansion in these areas therefore has to be through cross-border investment, rather than using Botswana as a base for exports.

Drivers of regional growth

While there are differences in the details of individual company experiences, the firms expanding cross-border share many similar characteristics. Firms have been able to expand primarily because they operate successful businesses in Botswana and, as a result, have strong balance sheets with retained profits from the existing Botswana operations, which gives the firms the requisite capital base to finance expansion.

Furthermore, the business environment in Botswana enables the firms to have access additional capital from various sources, whether from the banks, the BSE or regional sources. For instance, two of the companies have undertaken rights issues on the BSE to raise finance for regional expansion, while one raised capital from a share issue on the JSE. Another company noted that it was much cheaper to raise a US dollar loan from banks in Botswana than in Zambia. These business models can be introduced into various markets, albeit with the necessary provisions for variation to adapt to local circumstances. They have strong management teams, combined with high quality corporate governance associated with their BSE listing. All of these the attributes underpin regional expansion.

However, over and above the positive drivers that led the firms to expand regionally, there were negative drivers that existed in the Botswana economy and generally led to the consideration of regional operations. Given the very

Table 1: Company Profile

Company	Industry	Country	Year	Model^
Letshego	Financial Services	Uganda Swaziland Tanzania Zambia* Namibia Mozambique Kenya Lesotho Rwanda South Sudan*	2005 2006 2006 2007 2008 2011 2012 2012 2012 2012	G G G G B G B G B B
Turnstar	Property	Tanzania	2012	B
Funeral Services Group (FSG)	Consumer Services, Financial Services	Zambia South Africa	2009 2015	B B
Sefalana	Retail	Zambia Namibia	2009 2014	B G, B
PrimeTime	Property	Zambia	2012	B
RDCP	Property, Tourism	Madagascar South Africa	1999 2015	G G
Choppies	Retail	South Africa Zimbabwe Zambia Kenya	2008 2014 2015 2015	G B G B
Chobe	Tourism	Namibia		B
Cresta Marakanelo	Tourism	Zambia	2012	B
Furnmart	Retail	Namibia Zambia South Africa	1996 1998 2005	G G G
Wilderness	Tourism	Namibia South Africa Malawi Zimbabwe Zambia Seychelles Congo Kenya	1993 1993 1994 1995 2000 2003 2012 2012	G G G G G G G G
BIHL	Financial Services	Zambia Malawi Mozambique Tanzania Uganda Zambia	2000 2015 2015 2015 2015 2015	B B B B B B
Imara	Financial Services	UK Malawi South Africa Namibia Zambia Zimbabwe Mauritius Angola Kenya Nigeria	1990 1996 2003 2005 2005 2006 2008 2008 2009 2009	 G B B B B G G B B

Notes: ^ B – brownfield; G – greenfield; * The Zambia and South Sudan subsidiaries were sold in 2013 and 2015, respectively.
Source: Company reports and interviews

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small domestic market, firms were faced with limited opportunities for continued growth in Botswana, which was further exacerbated by slowing economic and population growth and intense competition in many sectors. Many of these firms occupy dominant positions in Botswana, which would eventually - and in some cases already has - induce a regulatory response from competition authorities. Furthermore, several firms reported that they lack the necessary human resource capacity in the domestic economy, which is worsened by the problems that firms face in accessing and importing foreign skills.

Prospects

The consideration of regional expansion was based on the various prospects and opportunities that the firms were presented with. The strengths of the firms could be harnessed in regional markets, some of which have similar characteristics to those of the Botswana business environment. Firms are then able to leverage their existing successful Botswana business models and management teams to exploit the often less well-served markets with weak competition from regional incumbents.

An added advantage is the access to a larger pool of human capital, skills and infrastructure that the firms gain from regional expansion. This stems from the somewhat constrained access to human resources in Botswana. Firms are also able to pursue regional expansion through possession of better access to capital (internal or external) than some of the incumbents in the region. This is aided by the potential use of Botswana as a base for regional operations, given the country's credit rating and a business environment that is, in many respects, more favourable than that in other countries.

The regional expansion described here is by no means complete. Several of the firms covered are considering entering new regional markets, with Namibia, Mozambique, Tanzania and Rwanda the main prospects, along with some consideration of West Africa. There is, however, no interest in expanding outside of Africa at this stage.

Risk

Despite these positive drivers, regional expansion comes with certain risks. Firstly, some Botswana firms have to deal with the response of regional competitors, especially South African firms, which can be much larger and have access to greater economies of scale.

Secondly, a failure to understand and adapt to regional variation in markets, cultures and regulatory issues could undermine the success of regional operations. Third, there is a risk of potentially over-extending management teams, or neglecting the Botswana operations, which could lead to stagnation in the core business in Botswana subsidiaries. Fourth, there are currency and exchange rate risks. While currency risk can to some extent be mitigated through the use of hedging or other financial instruments, this can be costly. Finally, many countries have a higher level of political and economic instability than firms may be used to in Botswana. For instance, RDCP's investment in Madagascar, and Letshego's investment in South Sudan, have both been adversely affected by political and economic instability in those countries.

The political stability that Botswana offers to business is offset by the fact that Botswana legislation makes access to resources, such as land and human capital, to support regional operations more difficult, which to some extent may explain why few companies from outside of Botswana have chosen to use the country as a regional operations hub.

Conclusion

There is a clear trend in the regional expansion of domestically listed BSE companies. However, the methods, strategies and rates of expansion by the firms involved differs across industries. What this expansion reveals is the fact that domestic growth prospects are limited and have been largely exhausted at least for some companies, hence the drive by firms to penetrate regional markets, which consequently provides access to a greater level of resources, infrastructure and skills. As such, the expansion provides firms with the opportunity to grow over and above the current level.

This type of outward FDI offers numerous benefits to Botswana. Besides supporting the growth of larger firms, it will also lead to future benefits to the balance of payments, by generating future inflows of foreign exchange.

In terms of the Botswana context, the expansion of BSE-listed firms is a good indication of how Botswana firms can be efficient and competitive in their operations, and can use this to underpin regional growth. However, there is a need for improvement in the Botswana business environment, as it is not enabling enough. Some of the firms reviewed are considering moving the base for their regional operations away from Botswana, particularly to South Africa, which offers better infrastructure and better access to skills. An improvement in the business environment would help to attract international firms to utilise Botswana as a regional hub.

PO Box 45016, Gaborone, Botswana

tel [+267] 390 0575
fax [+267] 390 0585

email keith@econsult.co.bw
brandon@econsult.co.bw
sethunya@econsult.co.bw
www.econsult.co.bw